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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 725

In re JAMES CONWAY, trading as Conway Negligees, Conway Beach Togs and Weehawken Knitting Mills,
Petitioner,

GERALD D. STONE, Trustee, and COMMERCIAL FACTORS CORPORATION,
Respondents.

BRIEF OF RESPONDENTS ON PETITION FOR WRIT OF *CERTIORARI* TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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SUBJECT INDEX.

	PAGE
TABLE OF CITATIONS	ii
QUESTIONS PRESENTED	1
STATEMENTS OF THE CASE	2
ARGUMENT	3
I. Neither insolvency in the bankruptcy sense nor an act of bankruptcy is a condition precedent to adjudication of a debtor under Sec. 376 of Chapter XI of the Bankruptcy Act	3
A. The Issue	3
B. Decisions and Analogous Legislation	5
(a) Extensions and compositions	5
(b) Corporate reorganizations	6
(c) Relief for farmers	6
(d) Railroad reorganizations	7
(e) Miscellaneous provisions	7
II. The failure to examine the debtor at the first meeting of creditors had no bearing on the result reached after hearing under Sec. 376	8
CONCLUSION	11

Table of Citations.

PAGE

Cases

Campbell vs. *Allegheny Corporation*, 75 F. (2) 947.. 6
Clinton, In Re, 41 F. (2) 749..... 8
Collins vs. *Welsh*, 75 F. (2) 894..... 5
Continental &c. Bank vs. *Chicago &c. Co.*, 294 U. S. 648 7
Dallas Joint Stock Land Bank vs. *Davis*, 83 F. (2) 322 6
Fox West Coast Theatres, In Re, 88 F. (2) 212.... 8
Johnson vs. *Zerbst*, 304 U. S. 456..... 11
Landquist, In Re, 70 F. (2) 929..... 5
Louisville Joint Stock Bank vs. *Radford*, 295 U. S. 555 7
Minnich vs. *Gardner*, 292 U. S. 48..... 10
National Ref. Co. vs. *Pennsylvania Petroleum Co.*, 66 F. (2) 914 8
New Rochelle Coal and Lumber Co., 77 F. (2) 881... 6
Pierce vs. *Somerset Railway*, 171 U. S. 641..... 11
Sterba, In Re, 74 F. (2) 413..... 5
United States vs. *Atkinson*, 297 U. S. 157..... 10
Wall vs. *Parrot Silver & Copper Co.*, 244 U. S. 407.. 11
West Co. vs. *Lea*, 174 U. S. 590..... 8

Bankruptcy Act.

Section 1 (19)..... 4
Section 3(a) and (b) 4

Chapter XI:
Section 323 4
Section 336 8
Section 376 (2) 3

Questions Presented.

I.

Is proof of insolvency or of the commission of an act of bankruptcy necessary before adjudging a debtor a bankrupt under Sec. 376(2) of Chapter XI of the Bankruptcy Act?

II.

Where a debtor under Chapter XI was not examined pursuant to the directions of Sec. 336 at a first meeting of creditors called under Sec. 334, does such failure to examine *per se* nullify a subsequent order of adjudication entered after hearing, under Sec. 376(2), where no objection to the non-examination was made by the debtor either at the meeting of creditors under Sec. 336, or at the hearing on the question of adjudication under Sec. 376?

Statement of the Case.

At the meeting of creditors held under Sec. 336, the overwhelming majority of creditors in number and amount affirmatively rejected the Plan of Arrangement. The Debtor was not examined at this meeting, but he did not object to this non-examination, nor did he request that he be examined.

To the order to show cause which issued under Sec. 376(2), the Debtor filed an Answer and Petition (R. 2), objecting to adjudication on the grounds that he was not "insolvent" and had not "committed an act of bankruptcy", and praying that the proceedings be dismissed. A hearing was held, but at no time did the Debtor object to adjudication on the ground that he was not examined at the first meeting of creditors under Sec. 336. In fact, this ground was not set forth in the Debtor's Petition for Review (R. 5), and it was first mentioned before the District Court in oral argument in the review proceedings (R. 27).

The Referee's order of adjudication was reversed by the District Court in December, 1940 (R. 14), on the ground that the Debtor had not been examined at the meeting of creditors held under Sec. 336, with directions to proceed further under Chapter XI. An appeal to the Circuit Court of Appeals resulted in a reversal of the District Court. After the mandate issued, the District Court, on August 11, 1941, entered an order reversing its prior order of December, 1940 and remanding the matter to the Referee for further proceedings. The Referee, by order of August 19, 1941, restored the *status quo ante,* as of December, 1940. The Debtor brought on before the District Court this last

order of the Referee, and on November 3, 1941 the District Court affirmed the Referee. On November 7, 1941 all of the assets of the Debtor were sold.

The requirement of conciseness forbids full comment on the Petitioner's financial picture (Brief, pp. 4-5). Suffice it to say that inventory, merchandise and machinery total $40,000.00—only in the opinion of the Debtor as stated in his petition under Chapter XI. As to the cash asset of $5,000.00, it represented money on deposit in a bank which seized and applied it toward the bankrupt's indebtedness of $8,000.00.

The opinion of the Circuit Court is reported in 121 Fed. (2) 972.

ARGUMENT.

I.

Neither insolvency in the bankruptcy sense nor an act of bankruptcy is a condition precedent to adjudication of a debtor under Sec. 376 of Chapter XI of the Bankruptcy Act.

A. The Issue.

Sec. 376 (2) of the Bankruptcy Act, under which the Referee entered the order of adjudication, pertinently reads as follows:

> "If an arrangement * * * is not accepted at the meeting of creditors * * * the court shall * * * (2) * * * enter an order, upon hearing after notice * * * either adjudging the debtor a bankrupt * * *

> or dismissing the proceedings under this chapter, whichever in the opinion of the court may be in the interest of the creditors." (11 U. S. C. A., Sec. 771.)

Despite the clear grant of power to courts of bankruptcy to adjudicate under these circumstances alone, the Debtor argued in his Answer and Petition (R. 2) and in his Petition of Review (R. 5) that the court could not adjudicate him a bankrupt unless the elements of "insolvency" and "an act of bankruptcy" were present, as set forth in Secs. 1 (19) and 3 of the Act which provides as follows:

> "Sec. 1 (19): A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property * * * shall not at a fair valuation be sufficient in amount to pay his debts;" (11 U. S. C. A., Sec. 1 (19).
>
> "Sec. 3: a. Acts of bankruptcy by a person shall consist of * * *
>
> b. A petition may be filed against a person within four months after the commission of an act of bankruptcy * * *" (11 U. S. C. A., Sec. 21).

Solvent, or not, the debtor was financially embarrassed:

> "Sec. 323. A petition filed under this chapter shall state that the debtor is insolvent or unable to pay his debts as they mature, * * * (11 U. S. C. A., Sec. 723).

The question is whether the congressional power to establish laws on bankruptcies (Article I, Sec. 8, Cl. 4, United States Constitution) embraces the power to estab-

lish laws governing the relationship between a financially embarrassed debtor and his creditors. Or, stated in terms of the case at bar, may Congress authorize courts of bankruptcy to adjudge a person a bankrupt even if he is solvent and has committed no act of bankruptcy?

B. Decisions and Analogous Legislation.

(a) Extensions and compositions.

The immediate predecessor of Chapter XI was Sec. 74 of the Bankruptcy Act (Mar. 3, 1933, Ch. 204, Sec. 1, 47 Stat. 1467, as amended June 7, 1934, Ch. 424, Sec. 2, 48 Stat. 922, 923; May 15, 1935, Ch. 14, Sec. 2, 49 Stat. 246). Under clause (a) a debtor had to allege insolvency or inability to pay his matured debts, and if a plan wasn't accepted by creditors at their meeting, the court could adjudicate the debtor a bankrupt under clause (1) without proof of insolvency or an act of bankruptcy.

The constitutionality of Sec. 74 was attacked on the ground that it attempted to bring within the jurisdiction of the federal bankruptcy courts the obligations and property of persons not insolvent, in the case of *In Re Landquist,* 70 F. (2) 929, C. C. A. 7, 1934, cert. den. 293 U. S. 584. The court disposed of the contention by saying that "Inability to pay has always been recognized as a proper cause of adjudication whether that inability were caused by the lack of assets or a lack of liquidity of assets." This position was reaffirmed by the same court a year later, *In Re Sterba,* 74 F. (2) 413, and was followed in *Collins* vs. *Welsh,* 75 F. (2) 894, (C. C. A. 9, cert. den. 295 U. S. 762).

(b) Corporate reorganizations.

There is a similar situation under Chapter X of the Bankruptcy Act governing corporate reorganizations. Sec. 130 (11 U. S. C. A., Sec. 530 (1) requires the petitioning corporation to allege insolvency or inability to pay debts as they mature, and if a plan is not accepted by creditors the judge may dismiss the proceedings or adjudicate the corporation a bankrupt under Sec. 236 (11 U. S. C. A., Sec. 636). The immediate predecessor of Chapter X was Sec. 77B of the Bankruptcy Act (June 7, 1934, Ch. 424, Sec. 1, 48 Stat. 912; amended Aug. 20, 1935, Ch. 577, 49 Stat. 664; Aug. 29, 1935, Ch. 809, 49 Stat. 965) where the provisions were encompassed in Sec. 77B (a) and (c) (8).

The same attack was made and again the statute was held constitutional in *Campbell* vs. *Allegheny Corporation,* 75 F. (2) 947, (C. C. A. 4, cert. den. 296 U. S. 581). The court said that, "All phases of the relationship between a debtor financially embarrassed and his creditors are brought under the control of Congress by the constitutional grant of power; and the fact that a particular mode has hitherto been employed in dealing with this relationship is not to be taken as a measure of the power over it." The same result was reached in *New Rochelle Coal and Lumber Co.,* 77 F. (2) 881, C. C. A. 2.

(c) Relief for farmers.

An analogous situation arose under the Farm Bankruptcy Act, Sec. 75 of the Bankruptcy Act (11 U. S. C. A., Sec. 203). In *Dallas Joint Stock Land Bank* vs. *Davis,* 83 F. (2) 322, (C. C. A. 5), the court said: "The authority of

Congress to make uniform laws on the subject of bankruptcy is a broad one. It extends to and authorizes not merely ordinary bankruptcy laws, as they were understood and in existence at the time of the adoption of the Constitution, but insolvency laws in general." And to the same effect is *Louisville Joint Stock Bank* vs. *Radford,* 295 U. S. 555.

(d) Railroad reorganizations.

Prior to Sec. 77 of the Bankruptcy Act (11 U. S. C. A., Sec. 205) a railroad could not be adjudged a voluntary or involuntary bankrupt (Sec. 4 (a) and (b) of the Bankruptcy Act). Under Sec. 77 the Congress authorized the bankruptcy courts to deal with railroads unable to pay matured debts, and this legislation, more novel than the legislative provisions involved in the case at bar, was held constitutional in *Continental Illinois National Bank and Trust Co.* vs. *Chicago &c. Co.,* 295 U. S. 648.

(e) Miscellaneous provisions.

There are similar provisions in Real Property Arrangements under Chapter XII of the Bankruptcy Act (11 U. S. C. A., Sec. 801) in Secs. 423, 481 and 482, and in Wage Earners' Plans under Chapter XIII of the Act (11 U. S. C. A., Sec. 1002) in Secs. 623 and 626.

Even under Chapter XI, a person merely unable to pay his matured debts may be adjudged a bankrupt if he fails to provide an indemnity bond (Sec. 327), or if he fails to carry out a confirmed arrangement (Sec. 376).

When our Debtor filed his petition under Chapter XI, the jurisdiction and powers of the bankruptcy court were

the same as if he had filed a voluntary petition for adjudication, Sec. 312 (2). If he had filed such a voluntary petition, the court could have adjudged him a bankrupt without any proof of insolvency or of an act of bankruptcy.

Re Fox West Coast Theatres, 88 F. (2) 212 (C. C. A. 9);
In Re Clinton, 41 F. (2) 749 (S. D. Cal.).

If an involuntary petition in bankruptcy is filed against a person under Sec. 4 (b) of the Bankruptcy Act, alleging as the act of bankruptcy a general assignment for creditors (Sec. 3 (a) (4), or the appointment of a general receiver (Sec. 3 (a) (5)), adjudication cannot be resisted by a debtor on the basis of his solvency.

West Co. vs. *Lea*, 174 U. S. 590;
National Ref. Co. vs. *Pennsylvania Petroleum Co.*, 66 F. (2) 914 (Cert. den. 291 U. S. 667).

II.

The failure to examine the debtor at the first meeting of creditors had no bearing on the result reached after hearing under Sec. 376.

On page 7 of the Petitioner's brief, he insinuates that the subsequent examination under Sec. 336 produced a majority of acceptances of the plan of arrangement. His conclusion is based solely on the fact that acceptances followed the examination in time. Naturally, the intervening conferences, meetings of the Creditors' Committee and the like, are not reported in the Record, and therefore the Record fails to disclose the true reason why the debtor was

able to obtain additional acceptances. However, it is only fair to this Court to point out that the examination under Sec. 336, which is referred to by the Petitioner as being influential, as strictly copied from the transcript of the testimony, discloses the following, in part:

> "Q. Will you tell us about this plan, its feasibility and fairness? * * * A. I will be glad to; we are offering you twenty per cent in cash and three notes of five per cent each, one payable August of this year and two payable next year; as to feasibility, we think enough of the plan to put up a bond, to put up part payment on the first twenty per cent of the $1,500.00, which was requested by the Committee.
>
> Q. Anything else you have to say? A. No.
>
> Q. Is there anything you want to say in connection with these proceedings that are now pending before the Court and the form of your application for confirmation of the plan and acceptance of the plan? A. No.
>
> Q. Is there anything you want to say to explain your plan further? A. The plan is self-explanatory.
>
> Q. Is there anything further you want to say to creditors so that they may better understand your plan or have better knowledge with reference to acceptance or rejection? A. Not knowing what questions will be in the creditors' minds, I cannot foretell. If they will ask me questions I will be glad to answer them.
>
> Q. There is nothing that you think you have to volunteer to assist them in understanding the situation better with reference to acceptance or rejection of the plan? A. No.
>
> Q. You say the plan is self-explanatory. A. I believe so.

> Q. Is this plan more self-explanatory than any other plan you have had on file here? A. I think all the plans are self-explanatory."

This portion of the examination, which continued further but which might have terminated there, rather forcefully indicates that the cry of the debtor for an opportunity to be examined under Sec. 336 is the creation of a sham issue.

On page 8 of the brief, Petitioner argues that an examination at the first meeting of creditors under Sec. 336 would have enabled the Referee to determine how to act under Sec. 376. The Petitioner overlooks the fact that a hearing is to be held and was held under Sec. 376 (R. 9). At that hearing the question was properly adjudication or dismissal, and an examination under Sec. 336 could not have been pointed toward these alternatives.

It is unquestioned that at the first meeting of creditors under Sec. 334 the debtor failed to request an examination and failed to object to his non-examination. At the hearing under Sec. 376(2) the prior non-examination was not presented as an objection to adjudication. The sole grounds relied on by the debtor were the fact that he was solvent, and did not commit an act of bankruptcy (R. 2, 6, 9, 27).

Minnich vs. *Gardner,* 292 U. S. 48;
U. S. vs. *Atkinson,* 297 U. S. 157.

The debtor does not object to the adjudication on the merits or on the ground that the Referee abused his discretion. Rather is his objection founded on the alleged lack of power of the Court to act under Sec. 376 because there was no examination under Sec. 336. However, if the Court

was powerless to adjudicate under Sec. 376, it was likewise powerless to dismiss under the same Section, yet the Petitioner asked the Court to exercise its power under Sec. 376 by praying for a dismissal (R. 2).

Petitioner's argument under the Fifth Amendment of the Constitution is without weight. The Circuit Court properly held that debtor could waive a constitutional provision intended for protection of his property rights.

Johnson v. *Zerbst,* 304 U. S. 456;
Wall v. *Parrot Silver & Copper Co.,* 244 U. S. 407;
Pierce v. *Somerset Railway,* 171 U. S. 641.

Wherefore it is respectfully submitted that the petition for a writ of *certiorari* be denied.

Respectfully submitted,

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